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Economic Outlook

Irving Trust

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The economy continues to plod along, with a few signs of improvement interspersed among indications of continuing difficulties. Business slowdowns such as the economy has been experiencing are normal during expansionary periods. They usually last from three to five quarters and are followed by a period of above-average growth. Although the slowdown that began last summer is indeed proving persistent, continued low inflation rates and declines in interest rates during the past year have laid the foundation for improved economic growth.

The inventory situation continues to show improvement, although the pattern is not clear-cut. For example, the inventory/sales ratio of general merchandise, apparel, and furniture stores--a large group sensitive to discretionary consumer purchases--is now considerably below the undesirably high levels that were reached at various points during the past year. This pattern indicates that retailers will soon have to increase orders to their vendors to keep their shelves stocked.

The industrial sector still shows many signs of stress, but its pattern of growth is now less disturbing than it was a few months ago. As of June, industrial production appeared to be on a plateau, falling a slight 0.4% from the peak in August 1984 to May 1985. After a recent major data overhaul and modest increases in June and July, the index of industrial production now shows a slight upward tilt, with the July level 1.1% higher than last August's level. Further increases in production in the months ahead are likely, but profits of industrial firms will still be under pressure as capacity utilization rates remain below optimal levels and as low-cost imports limit domestic manufacturers' ability to raise prices and improve profit margins.

Despite declines in mortgage rates of two percentage points during the past year, housing starts in the last few months have been disappointing. Initially, housing starts seemed to respond to the declines in rates, rising from 1.56 million units last October to about 1.9 million in March and April. Housing starts have fallen since then, however, and were only 1.65 million units in July.

Several factors are responsible for the hesitation. Some areas of the country, such as parts of Florida and Texas, have been overbuilt. In addition, mortgage delinquencies have become a major problem of late; the mortgage delinquency ratio hit a record high in May (based on data going back to the early 1970s). As a result, many lenders have tightened credit qualifications--a wise move, but one that reduces the number of potential home buyers. Fannie Mae has recently announced that it will further tighten its standards on the mortgages--particularly low downpayment mortgages--it buys for resale, effective in October. In any case, it now seems that a reassessment of credit standards is warranted, even if it means somewhat less growth in housing. Furthermore, the tax reform proposals have introduced major elements of uncertainty into the housing market. Housing starts are now expected to total 1.72 million units in 1985 and 1.64 million units in 1986, compared to 1.75 million in 1984.

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Economic Forecast

Percent Changes at Annual Rates

	Actual		1985		Forecast				Actual	Forecast	
								1986	1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	5.6	4.7	7.6	8.9	8.4	8.0	6.1	7.5	10.8	6.5	7.7
Real GNP	0.3	2.0	4.1	4.8	4.0	3.8	1.5	2.5	6.8	2.7	3.6
GNP Price Deflator	5.4	2.7	3.4	3.9	4.3	4.0	4.5	4.9	3.8	3.7	4.0

	Actual	Forecast	Actual	Forecast	
	1985: II	1985:III	1983-1984	1984-1985	1985-1986
Consumer Spending	8.6%	6.1%	8.6%	7.4%	8.2%
Durable Goods	6.3	1.3	13.9	7.2	7.5
Nondurable Goods	7.1	2.5	6.9	4.4	6.5
Services	10.3	10.1	8.5	9.7	9.5
Business Capital Spending	12.6	11.7	20.6	10.8	10.2
Structures	14.0	14.8	16.0	14.0	10.8
Equipment	11.8	9.9	23.4	9.0	9.8
Residential Investment	8.1	9.6	16.4	3.2	1.7
			1984	1985	1986
Change in Inventories	$18.1b.	$26.0b.	$58.2b.	$29.7b.	$38.5b.
Net Exports of Goods and Services	$-93.4b.	$-107.0b.	$-64.2b.	$-95.1b.	$-119.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	9.5%	12.0%	9.0%	9.7%	7.5%
Federal	5.0	16.8	9.5	11.6	6.2
Defense	12.0	9.8	10.5	9.6	7.2
Other	-12.5	39.5	6.7	17.6	3.3
State & Local	12.7	8.8	8.7	8.4	8.4
Corporate Profits Before Tax	-10.1*	2.1*	16.0	-3.1	8.1
Corporate Profits After Tax	-9.1*	-0.1*	14.5	-3.5	8.2
Plant and Equipment Expenditures	4.4	16.1	16.0	9.2	7.3
Real Final Sales#	4.7	3.3	5.0	3.4	3.4
Real Disposable Personal Income	8.1	3.5	6.7	3.4	4.0

Economic Indicators	Recent Data			Actual	Forecast	
	May	June	July	1983-1984	1984-1985	1985-1986
Consumer Price Index**	2.4%	2.4%	n.a.	4.0%	4.1%	4.5%
Producer Price Index for Finished Goods**	2.4	-2.4	3.6	1.7	2.8	3.7
Industrial Production	2.4	3.6	2.4	11.5	2.8	3.6
Retail Sales**	-0.4	-1.4	0.4	10.5	6.6	6.8
				1984	1985	1986
Auto Sales (millions of units, a.r.)	11.3	10.3	10.3	10.4	10.8	10.3
Housing Starts (millions of units, a.r.)	1.68	1.69	1.65	1.75	1.72	1.64
Unemployment Rate	7.3	7.3	7.3	7.5	7.3	7.0
Merchandise Trade Deficit (a.r.)	$152.0b.	$161.0b.	n.a.	$123 3b.	$150.0b.	$170.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

*GNP less change in inventories, both in real terms.
**Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast

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